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Self-Managed Superannuation Funds (SMSF)

What is an SMSF?
Similar to other superannuation funds, an SMSF is a way to save for your retirement. The main difference between an SMSF and other types of superannuation funds is that generally, the members of an SMSF are also the trustees. This allows the member to run the fund directly for their own benefit. An SMSF is regulated by the Australian Taxation Office (ATO). As is the case with any superannuation investments, you are unable to access or benefit from the funds until a condition of release has been met.

Structures
When you make the decision to setup an SMSF, as a member, you will also become a trustee (or the director of a company that is a trustee) of the fund. A trustee is a person or company that holds and invests a fund's assets for the benefit of the members' retirement.

A corporate trustee is a company incorporated under the Corporations Act that acts as a trustee for the fund. Generally, to be an SMSF, all directors of the company need to be members and all members need to be directors of the company.

In a corporate trustee structure with multiple directors, upon the death of a member, a successor director can step into the place of the deceased member relatively quickly. However, when there are individual trustees, there may be considerable paperwork and time associated with administering a deceased trustee's estate.

Responsibilities
As an SMSF trustee, you must act according to your fund's trust deed and the superannuation and tax laws. If there's a conflict between the superannuation laws and the trust deed, the law overrides the trust deed.

At the heart of the superannuation laws is a principle called the 'sole purpose test'. This means your fund needs to be maintained for the sole purpose of providing retirement benefits to your members (or to their dependants if a member dies before retirement). As a trustee, you need to maintain your SMSF so that it complies with the sole purpose test at all times, including when investing fund assets and paying benefits upon retirement of members.

Other responsibilities include ensuring that:
- All contributions and payments to members and their beneficiaries must be in accordance with superannuation and taxation laws and the SMSF Trust Deed;
- The fund's assets are valued at market value for the preparation of financial accounts and statements;
- The reporting and administration obligations imposed by the Australian Taxation Office (ATO) are being met.

Failing to comply with the obligations set out under the superannuation laws can have significant consequences on the fund and the trustees. An important point to also remember is that all trustees are equally required to comply with these trustee responsibilities and are liable for the actions of other trustees.

As a trustee you can outsource the functions if you do not have the time and skills required but you will still be ultimately responsible for the operation of the SMSF. Where you do not outsource the functions, you will have to ensure that you keep up to date on all current developments or changes in superannuation and taxation laws and are able to administer the day to day requirements of the fund.

As a trustee or director, you're responsible for running the fund and making decisions that affect the retirement interests of each fund member, including yourself. You need to comply with the superannuation and tax laws so your fund is entitled to tax concessions and members' interests are protected. The ATO's trustee's declaration form will need to be completed within 21 days of becoming an SMSF Trustee.

You are required to:

- act in the best interests of all fund members when you make decisions;
- act honestly in all matters concerning the SMSF;
- exercise skill, care and diligence in managing the SMSF;
- comply with the SMSF trust deed and review and update it as required;
- have a documented investment strategy that is regularly reviewed and updated;
- manage the fund separately from your own affairs;
- accept and document contributions in accordance with superannuation law;
- keep proper and accurate tax and superannuation records;
- ensure the money in the fund is only accessed where the trust deed and law allows it;
- know, understand and meet your responsibilities and obligations;
- ensure your SMSF is independently audited every year;
- lodge your SMSF annual return and other reporting obligations to the ATO every financial year; and
- pay the supervisory levy.

All trustees and directors are equally responsible for managing the fund and making decisions. Anyone over the age of 18 years can be a trustee of an SMSF as long as they are not under a legal disability (such as a mental incapacity) or a disqualified person.

Trust Deed

A trust deed is a legal document that sets out the rules for establishing and operating your fund – things like the fund's objectives, who can be a member and how benefits are paid. The trust deed and superannuation laws together form the fund's 'governing rules'.

The trust deed must be:

- Prepared by someone qualified to do so;
- Signed and dated by all trustees;
- Properly executed according to state or territory laws; and
- Regularly reviewed, and updated as necessary.

Investment Strategy

An investment strategy will also need to be included as part of your trust documents. It is a formal plan identifying the SMSF's financial goals (investment objectives) and the tolerance for risk and investment time horizon. As a trustee of the fund, you should regularly review the fund's investment strategy to ensure it remains current.

Restrictions on SMSF investing

Investments within an SMSF must be made on a 'arm's length' basis. This basically means that the sale price of the asset should always reflect the true market value. Income of the assets must show a true rate of market return.

SMSF Costs

Some of the costs associated with SMSFs could include but are not limited to:

- Initial advice fees;
- Establishment costs;
- Ongoing admin fees;
- Audit fees;
- Legal fees.

Advantages of setting up an SMSF

- An SMSF can offer greater flexibility to invest in a wide range of assets and investment choices;
- Members are able to pool their superannuation funds to increase the purchasing power;
- All members are involved in the decision making process.

Disadvantages of setting up an SMSF

- An SMSF that is focused on a particular investment will suffer from lack of diversification and may drop in value in times of financial uncertainty;
- Unavoidable costs include:
    - The annual SMSF supervisory levy (collected by the ATO);
    - Preparing and lodging ATO application costs;
    - The costs to produce and annual financial statement and tax return;
    - Annual independent audit fees;
    - Costs relating to the establishment of the SMSF, including costs for a trust deed & investment strategy;
    - The fee for an annual actuarial certification (when required).
- Optional costs include:
    - Establishment of a corporate trustee, including ASIC fees to establish a corporate entity;
    - Professional investment advice fees;
    - Accounting and bookkeeping fees;
    - Investment and management fees.
- Trustees are responsible for complying with all legal obligations;
- Trustees are required to develop, implement and regularly review an investment strategy for the fund;
- Trustees are ultimately responsible for the management of the fund even if the duties are outsourced;
- Failure to comply with the legal obligations will cause the fund to become non-complying and a tax of 46.5% may be levied. The trustees may also be liable for punishment;
- If you are approaching pension phase, there may be a point at which the SMSF may cease to be cost-effective because fixed costs may remain constant or increase while the balance of the fund diminishes; and
- Rolling over all of your superannuation funds from a retail account into your SMSF will result in a loss of insurance cover unless further cover is obtained through the SMSF.

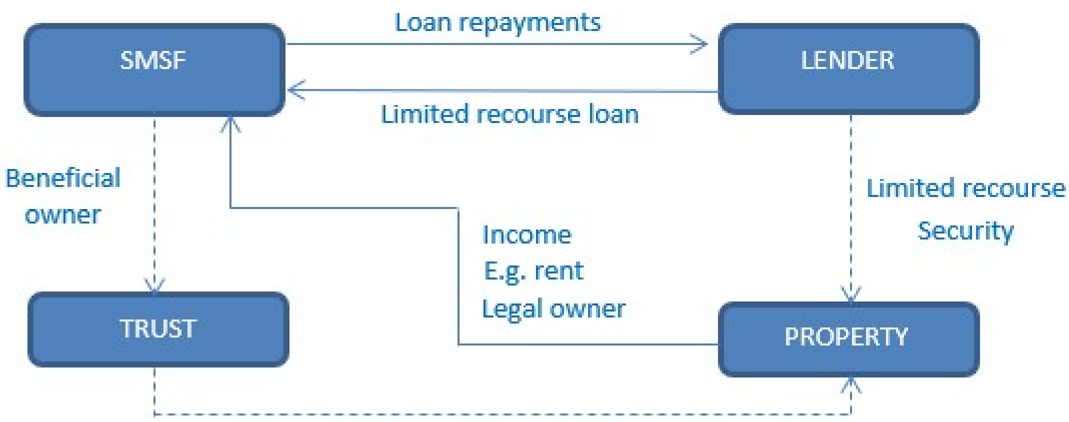
Risks associated with SMSFs

Risk	Description
Lack of statutory compensation	SMSFs are not subject to the same government protections that are available in APRA-regulated superannuation funds. When transferring an existing superannuation account balance from a superannuation fund regulated by the Australian Prudential Regulation Authority (APRA) to an SMSF, things to consider include: • Members will be taking themselves outside the compensation framework available to investors in an APRA-regulated superannuation fund in the event of theft or fraud on the fund • Members will not be eligible for compensation under superannuation laws if the SMSF suffers loss as a result of theft or fraud in the underlying investment asset.
Impact on insurance	Life and TPD insurance is generally more expensive and harder to obtain for SMSFs than for larger APRA-regulated superannuation funds, which can often also offer default levels of cover without a medical assessment. Unless the SMSF trustee specifically takes out insurance for fund members, there may be no cover.
Access to complaints mechanisms	Certain dispute resolution mechanisms, such as the Superannuation Complaints Tribunal (SCT), may not be available to SMSFs.
The appropriateness of different SMSF structures	It be costly to change structures, ownership of assets and trustees after the SMSF has been established. See the 'Structures' section for more detail.
Trustee obligations and the time and skills necessary to operate an SMSF	Obligations with which SMSF trustees must comply under superannuation and taxation laws include: • maintaining the fund for the sole purpose of providing retirement benefits to SMSF members, or to their dependants if a member dies before retirement; • accepting contributions and paying benefits (pension or lump sums) to members and their beneficiaries in accordance with superannuation and taxation laws and the SMSF trust deed; • valuing the fund's assets at market value for the preparation of financial accounts and statements; • having the financial accounts and statements for the SMSF audited each year by an approved SMSF auditor; and • meeting the reporting and administration obligations imposed by the Australian Taxation Office (ATO).
Trustee obligations to develop an investment strategy	SMSF trustees should conduct a regular review of the fund's investment strategy to ensure it remains current. It is important that trustees understand: • the benefits associated with asset diversification and investing across a number of asset classes (e.g. shares, real property and fixed interest products) in a long-term investment strategy, such as improving the risk and return profile of an SMSF; • there are some restrictions on SMSF investments; and • certain transactions are prohibited, such as lending the fund's money, or providing financial assistance, to a member of the fund or their relatives.

The need to consider an exit strategy	Trustees may want to wind up their SMSF for a wide range of reasons. To make any exit as straightforward as possible, it is important that trustees consider and develop an exit strategy for their SMSF. Specific wind-up requirements should be included in the fund's trust deed. The events that could lead to the fund winding up should be outlined as well as how members' super will be paid out or rolled over in those circumstances.

Insurance
It is a legislative requirement that SMSF trustees consider the insurance needs of the SMSF members when drafting the fund's investment strategy. The three main types of insurance which can be held within an SMSF includes Term Life, Total and Permanent Disability and Income Protection (salary continuance).

Limited Recourse Borrowing Arrangement (LRBA)
Borrowing or gearing your super into property must be done under strict borrowing conditions called a 'limited recourse borrowing arrangement' (LRBA). An LRBA arrangement provides you with the right but not the obligation to buy an asset through the payment of instalments. The fund will receive any interest generated by the asset, however will not have the legal ownership over the asset until the loan is repaid.



The following steps need to be completed in order to establish the limited borrowing arrangement:
1) Ensure your trust deed allows for the arrangement;
2) Identify the assets to be purchased;
3) Meet with a specialist SMSF advisers;
4) Establish a holding trust; and
5) Meet with a lending specialist and apply for a loan and purchase the asset.

Contact Norman Angwar at 0450 8484 995 or at norman@wealthalliance.com.au for more information.

Disclaimer: this SMSF guide is is developed without taking into account your objectives, financial situation or needs. It should not be used, relied upon, or treated as a substitute for specific professional advice.